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No. 96-365

In the Supreme Court of the United States

OCTOBER TERM, 1996

ARNOLD AND BAKER FARMS, PETITIONER

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the debtor's Chapter 11 reorganization plan, which would transfer to respondent United States only a portion of respondent's collateral, provided the "indubitable equivalent" of the respondent's secured claim, as required by 11 U.S.C. 1129(b)(2)(A)(iii).

2. Whether the court of appeals, after determining that the facts found by the bankruptcy court were not clearly erroneous, was prohibited from reviewing de novo the bankruptcy court's ultimate conclusion that the substitute collateral provided respondent the indubitable equivalent of its secured claim.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 38a-56a) is reported at 85 F.3d 1415. The opinion of the Bankruptcy Appellate Panel (Pet. App. 8a-37a) is reported at 177 B.R. 648. The order of the Bankruptcy Court (Pet. App. 1a-7a) is unpublished.

JURISDICTION

The judgment of the court of appeals was entered on June 7, 1996. The petition for a writ of certiorari was filed on September 5, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Arnold and Baker Farms is a partnership formed for the purposes of farming and selling and leasing farmland. Pet. App. 9a. In April 1986 petitioner filed a voluntary petition for relief in the United States District Court for the District of Arizona under Chapter 11 of the Bankruptcy Code. The Farmers Home Administration (FmHA)[1] filed a secured claim for approximately $3,837,618, plus interest accruing beginning June 30, 1991, at $594 per day. C.A. E.R. 127. Petitioner's second amended plan (the Plan), which is the plan at issue here, included a "dirt for debt" transfer through which petitioner proposed to satisfy FmHA's secured claim with a transfer of 515 acres of land, less than half of the 1320 acres securing the claim. Pet. App. 11a.

The parties disagreed sharply over the value of the land in the proposed transfer. Petitioner claimed that the best and highest use of the property was for land development, and it valued the land at $7,322 per acre. Pet. App. 18a & n.3. FmHA maintained that the best and highest use of the property was for farmland, and thus its value was only $1,381 per acre. *Id.* at 9a-11a, 18a. Accordingly, it opposed the Plan. Petitioner invoked the "cram down" provision of Chapter 11, under which a court may confirm a reorganization plan over

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[1] After the commencement of this litigation, the functions of the former Farmers Home Administration were transferred to the Consolidated Farm Service Agency which was, in turn, renamed the Farm Service Agency. See Department of Agriculture Reorganization Act of 1994, Pub. L. No. 103-354, § 226, 108 Stat. 3214 (Oct. 13, 1994); Memorandum from Mike Espy, Secretary of Agriculture, No. 1010-1 (Oct. 20, 1994). We refer to the agency as the Farmers Home Administration in this brief to avoid confusion.

the objections of an impaired creditor, provided the plan is "fair and equitable." 11 U.S.C. 1129(b)(1). A plan is "fair and equitable" to a secured creditor if it provides the creditor the "indubitable equivalent" of its secured claim. 11 U.S.C. 1129(b)(2)(A)(iii).

2. The bankruptcy court valued the land at $7,300 per acre and, after adding 53 acres to the transfer to FmHA to compensate it for the costs of selling the land, confirmed the Plan over FmHA's objection. Pet. App. 3a. The bankruptcy court concluded that the property was of "a value sufficient to satisfy [FmHA's] claims in full" and therefore provided FmHA with the "indubitable equivalent" of its secured claims. *Id.* at 5a.

3. The Bankruptcy Appellate Panel of the Ninth Circuit (BAP) reversed.[2] Pet. App. 8a-37a. Although the BAP was "troubled" that the bankruptcy court's valuation of the property "ignored the effect on the market" of a nearby 1900-acre parcel held by the Resolution Trust Corporation (RTC) and already on the market, *id.* at 21a, it did not consider the valuation clearly erroneous, *id.* at 22a. The BAP concluded, however, after de novo review, that the plan did not guarantee FmHA the indubitable equivalent of its secured claim. *Id.* at 31a, 33a. To constitute an indubitable equivalent, the partial transfer of collateral must be "completely compensatory" and must "insure the safety of or prevent jeopardy to the principal." *Id.* at 28a, 31a (quoting *In re Murel Holding Corp.*, 75 F.2d 941, 942 (2d Cir. 1935)). The BAP concluded that FmHA's principal was jeopardized by the illiquidity of the property and the uncertainty of sale. The BAP

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[2] The BAP sat in lieu of the district court pursuant to 28 U.S.C. 158(b)(1).

noted that the RTC, unable to dispose of the 19,000 acres it held in the same area, had extended its normal one-year marketing period to three years. Pet. App. 31a. The BAP also observed that FmHA had proffered evidence supporting a much lower valuation for the land and that the "large disparity in the parties' valuation of the same property illustrates the obvious uncertainty in attempting to forecast" the sale price of the property "at some uncertain future date." *Ibid.* The BAP concluded that, "[u]nder the circumstances of this case," the proposed transfer therefore could not be deemed the indubitable equivalent of FmHA's claim. *Id.* at 32a.

4. The court of appeals affirmed. Pet. App. 39a-56a. It agreed with the BAP that the bankruptcy court's valuation of property was a question of fact, reviewable only for clear error, but that whether the property so valued constituted the indubitable equivalent of the creditor's secured claim was a question of law, reviewable de novo. *Id.* at 50a. The court of appeals also agreed with the BAP on the merits, holding that the Plan failed to provide FmHA with the indubitable equivalent of its secured claim as required by 11 U.S.C. 1129(b)(2)(A)(iii), because the partial distribution of collateral to FmHA did not insure the safety of, or prevent jeopardy to, the principal. Pet. App. 50a-56a.

ARGUMENT

The decision of the court below is correct in all respects. There is no dispute about the proper legal standard for determining indubitable equivalence, and the BAP and the court of appeals correctly applied that standard in concluding that petitioner's proposed Plan did not provide FmHA with the indubitable

equivalent of its secured claim. Although there is disagreement among the courts of appeals in articulating the standard of appellate review of indubitable equivalence determinations, this case was correctly decided under any standard that has been articulated. Moreover, the disagreement among the courts of appeals may dissipate in light of intervening decisions of this Court clarifying the applicable standards of appellate review of mixed questions of fact and law.

1. Petitioner argues (Pet. 9-13) that the court of appeals erred in concluding that its proposed dirt for debt transfer failed to provide FmHA with the indubitable equivalent of its secured claim. The court of appeals correctly decided that issue, however, and its decision does not conflict with that of any other circuit.

a. Congress chose a particularly demanding standard for protecting secured creditors: "'Indubitable' means 'too evident to be doubted.'" *In re Walat Farms, Inc.*, 70 B.R. 330, 334 (Bankr. E.D. Mich. 1987) (quoting *Webster's Ninth New Collegiate Dictionary* 615 (1985)). The "indubitable equivalence" requirement originated in *In re Murel Holding Corp.*, 75 F.2d 941, 942 (2d Cir. 1935) (L. Hand, J.). In determining whether a creditor received "adequate protection," Judge Learned Hand stated:

> It is plain that "adequate protection" must be completely compensatory; and that payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference, but a creditor who fears the safety of his principal will scarcely be content with that; he wishes to get his money or at least the property. We see no need to suppose that the statute

> was intended to deprive him of that * * *, unless by a substitute of the most indubitable equivalence.

Ibid. Congress's adoption of the "indubitable equivalence" standard reflects its intent that "[s]ecured creditors should not be deprived of the benefit of their bargain." H.R. Rep. No. 595, 95th Cong., 1st Sess. 339 (1977).[3]

b. The court of appeals correctly concluded that the Plan failed to satisfy this demanding standard. Even accepting the bankruptcy court's determination of the expected value of the land, its illiquidity and the risks associated with its sale prevent it from constituting the indubitable equivalent of FmHA's secured claim. Petitioner own appraisal, which was accepted by the bankruptcy court, acknowledged that the "problems of the area" would require FmHA to hold the property for two years before selling it, Pet. App. 19a n.4, thus shifting to FmHA the risks that the forecast of the value was incorrect or that the market would decline. FmHA also bears the risk that land development will not prove to be the best and highest use of the land; this risk is real, given that the land, although annexed by an adjacent city, was without city water, sewer, and other services. C.A. E.R. 409, 420-422. Further undermining confidence in the equivalence of the substitute collateral was RTC's contemplation of the bulk sale of adjacent lands at no more than $2,105 per acre. Pet. App. 52a. The profound difference of expert opinions regarding the value of the land only underscores the dubious

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[3] "[I]ndubitable equivalen[ce]" is also used in 11 U.S.C. 361, a related provision addressing "adequate protection" for creditors, but appears nowhere else in the U.S. Code.

equivalence of this transfer. Compare *id.* at 31a-32a with *Murel*, 75 F.2d at 942-943. In these circumstances, a creditor shoulders considerable risks that the transfer of the substitute collateral will not be "completely compensatory," *Murel*, 75 F.2d at 942, or "insure the safety of or prevent jeopardy to the principal," Pet. App. 31a. Consequently, the transfer does not provide the indubitable equivalent of the secured claim.

c. Contrary to petitioner's assertion (Pet. 5), the court of appeals did not hold "as a matter of law" that the partial distribution of collateral could never satisfy the indubitable equivalence standard. To the contrary, both the court of appeals and the BAP stressed that "[t]he determination of whether a partial dirt for debt distribution will provide the creditor with the indubitable equivalence of its secured claim must be made on a case-by-case basis." Pet. App. 50a, 32a. Petitioner has cited no court of appeals decision in which an analogous plan was forced upon a creditor. Its reliance on *In re Sandy Ridge Development Corp.*, 881 F.2d 1346 (5th Cir. 1989), is unavailing. In that case, the reorganization plan called for the transfer of *all* the property securing the claim. The court concluded that "since common sense tells us that property is the indubitable equivalent of itself," the plan satisfied Section 1129(b)(2)(A)(iii), without regard for the exact value of the land. 881 F.2d at 1349-1350. The court of appeals below correctly distinguished *Sandy Ridge* as dealing with the transfer of the entire collateral. Pet. App. 56a; see also *id.* at 54a n.9 (observing that none of the other "dirt for debt" decisions cited by petitioner "required a secured creditor to accept part of its collateral in full satisfaction of its secured claim"). In such a case, valuation

is "unimportant" for resolving the issue of indubitable equivalence. *Sandy Ridge*, 881 F.2d at 1349.

2. a. The court of appeals correctly reviewed de novo the bankruptcy court's ultimate conclusion of indubitable equivalence. A determination of indubitable equivalence under Sections 361(3) and 1129(b)(2)(A)(iii) of the Bankruptcy Code is a classic mixed question of fact and law: "[T]he historical facts are admitted or established, the rule of law is undisputed, and the issue is whether the facts satisfy the statutory standard, or to put it another way, whether the rule of law as applied to the established facts is or is not violated." *Pullman-Standard* v. *Swint*, 456 U.S. 273, 289 & n.19 (1982). Here, the underlying fact to be established is the expected value of the collateral; the bankruptcy court makes that valuation based on a preponderance of the evidence, and that determination is subject to review only for clear error. But the court's ultimate decision—whether, based upon the factual findings, a plan provides a creditor with the indubitable equivalent of a secured claim—is correctly subject to independent appellate review. Cf. *Harper & Row, Publishers, Inc.* v. *Nation Enterprises*, 471 U.S. 539, 560 (1985); *Helvering* v. *Tex-Penn Oil Co.*, 300 U.S. 481, 491 (1937).

A determination of indubitable equivalence is analogous to the determination of a "fair use" of copyrighted material. In copyright, once the district court makes factual findings relative to the four factors that comprise fair use—the purpose of the use, the nature of the copyrighted work, the amount and substantiality of the portion used, and the effect on the market for the copyrighted work—an appellate court may independently review the ultimate de-

termination of whether the challenged use is fair. *Harper & Row*, 471 U.S. at 560-561. Similarly, in bankruptcy, once the bankruptcy court makes factual findings about the valuation of property, the appellate court may independently review the ultimate determination of whether the proposed cram down provides the indubitable equivalent of a creditor's secured claim—that is, whether the plan is "fair and equitable." Cf. *Ornelas* v. *United States*, 116 S. Ct. 1657, 1658, 1662 (1996) (although findings of historical fact surrounding search are to be reviewed "only for clear error," "[t]he ultimate questions of reasonable suspicion to stop and probable cause to make a warrantless search should be reviewed *de novo*"); *Thompson* v. *Keohane*, 116 S. Ct. 457, 466 (1995) (once underlying facts surrounding an interrogation are resolved, ultimate determination of whether a person was "in custody" is subject to independent review).

This standard of review appropriately recognizes that the subsidiary question of expected value and the ultimate question of indubitable equivalence are distinct. The bankruptcy court values collateral based on a preponderance of the evidence before it. Where there is a ready market for collateral, its value may be determined with ease and certainty. See, *e.g.*, *In re George Ruggiere Chrysler-Plymouth*, 727 F.2d 1017, 1020 (11th Cir. 1984). In such cases, collateral so valued generally will provide the creditor with the indubitable equivalent of a secured claim that is not of greater value. In contrast, where the market for the collateral is remote or uncertain, the bankruptcy court's valuation of the collateral, even if well supported, may or may not provide the degree of protection required by the indubitable equivalence standard. Compare *In re Walat Farms, Inc.*, 70 B.R. at 335

("[N]o matter how hot the market for real estate may become in the future, the market for farm real estate here and now is not such which would permit us to hold that the value of the land being offered is the indubitable equivalent of [the creditor's] claim.") (footnote omitted), with *In re James Wilson Associates*, 965 F.2d 160, 172 (7th Cir. 1992) (creditor was provided with indubitable equivalent of lien where security was worth almost twice as much as loan and expert testimony established that excess security provided considerable cushion against impact of potential default).

b. Petitioner correctly points out (Pet. 4-5) that other courts of appeals have treated indubitable equivalence or adequate protection determinations as wholly factual, and thus reviewable for clear error. See *In re James Wilson Associates*, 965 F.2d at 172; *In re O'Connor*, 808 F.2d 1393, 1396 (10th Cir. 1987); *In re Martin*, 761 F.2d 472, 474 (8th Cir. 1985); *In re Snowshoe Co.*, 789 F.2d 1085, 1088 (4th Cir. 1986); *In re George Ruggiere Chrysler-Plymouth*, 727 F.2d at 1020.[4] The practical significance of this conflict, how-

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[4] Petitioner errs, however, in stating that the Fifth Circuit reviews indubitable equivalence determinations only for clear error. In *In re Sun Country Development, Inc.*, 764 F.2d 406, 409 (1985), that court appeared to distinguish between the bankruptcy court's factual findings and its ultimate conclusion:

> To the extent [the creditor] attacks the findings of the bankruptcy court, we reject his complaints, as the findings were supported by the evidence. We further believe that [the creditor's] other concerns do not render the [substitute collateral] dubitable equivalent of the original first lien.

A subsequent panel of the Fifth Circuit left open the question whether adequate protection was wholly a question of fact. *In re First South Savings Ass'n*, 820 F.2d 700, 711 (1987) (finding

ever, is unclear. In *Martin*, for example, while the Eighth Circuit viewed adequate protection (which can be achieved through indubitable equivalence) as a question of fact, it reviewed de novo the bankruptcy court's adequate protection finding on the ground that it was predicated on a misunderstanding of the law. 761 F.2d at 475. The bankruptcy court's error was to give "insufficient weight to * * * the Congressional goal of affording the secured creditor the benefit of its bargain," by failing to identify and take proper account of the risks associated with the debtor's proposal. *Id.* at 478 (quoting *In re American Mariner Indus., Inc.*, 734 F.2d 426, 434-435 (9th Cir. 1984)). This analysis, under which the Eighth Circuit independently reviewed and reversed an indubitable equivalence determination that failed to protect the secured creditor against risks of unsecured losses, differed little from the analysis of the decision below.

Moreover, several of the circuits that have adopted the clearly erroneous standard for reviewing indubitable equivalence determinations did so a decade ago, without the benefit of this Court's recent decisions concerning mixed questions of law and fact. Given the opportunity, those circuits might reexamine their precedent and adopt a standard consistent with *Ornelas*, *Keohane*, *Harper & Row*, and the decision below.

Finally, for the reasons discussed at pages 6-7, *supra*, the application of a narrower standard of review would not likely change the result in this case.

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no need to decide whether "adequate protection is a finding of fact, reviewed only under the narrow 'clearly erroneous' standard" because challenged plan failed even that deferential standard).

Given the uncertainties and risks surrounding the sale and value of the land at issue, the bankruptcy court clearly erred in concluding that it constituted the indubitable equivalent of FmHA's secured claim. This case, therefore, would not provide a good vehicle for plenary consideration of the issue.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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